United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

75-4141

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Docket Nos. 74-1173, 74-1199 (Consolidated with Nos. 74-1172 and 74-1174 and with Nos. 73-1574, 73-2138, 73-2239)

TED BATES & COMPANY, INC.,
Petitioner,

against

FEDERAL TRADE COMMISSION,
Respondent.

ON PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL TRADE COMMISSION

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE*

DONOVAN LEISURE NEWTON & IRVINE
30 Rockefeller Plaza
New York, New York 10020
Attorneys for the American Association of Advertising Agencies, Inc. as Amicus Curiae

Of Counsel:

MAHLON F. PERKINS, JR.
THOMAS R. TROWBRIDGE, III

October 1, 1974

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Docket Nos. 74-1173, 74-1199 (Consolidated with Nos. 74-1172 and 74-1174, and with Nos. 73-1574, 73-2138, 73-2239)

TED BATES & COMPANY, INC.,
Petitioner,

against

FEDERAL TRADE COMMISSION,
Respondent.

ON PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL TRADE COMMISSION

BRIEF OF THE AMERICAN ASSOCIATION OF ADVERTISING AGENCIES, INC., AS *AMICUS CURIAE*

DONOVAN LEISURE NEWTON & IRVINE
30 Rockefeller Plaza
New York, New York 10020
Attorneys for the American Association of Advertising Agencies, Inc. as Amicus Curiae

Of Counsel:

MAHLON F. PERKINS, JR.
THOMAS R. TROWBRIDGE, III

INDEX

Authorities Cited

Cases:

* Cases chiefly relied upon are marked by asterisks.

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Docket Nos. 74-1173, 74-1199 (Consolidated with Nos. 74-1172 and 74-1174, and with Nos. 73-1574, 73-2138, 73-2239)

TED BATES & COMPANY, INC.,
Petitioner,

against

FEDERAL TRADE COMMISSION,
Respondent.

ON PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL TRADE COMMISSION

BRIEF OF *AMICUS CURIAE*

Interest of *Amicus Curiae*

The interest of the *amicus curiae* is set forth in the motion to which this brief is appended.

Question Presented

This brief will discuss the question: Should an order to cease and desist entered against an advertising agency by the Federal Trade Commission include a clause under which the agency would not be liable for a representation made in violation of that order unless it knew or should have known that the representation was false or deceptive?

[This case was not previously before this Court under the same or similar title.]

Statement

This statement treats only those aspects of the case that relate to the interest of the A.A.A.A. and its members.

The complaint in this matter charged ITT and Bates with making deceptive and unfair advertising claims as to the nutritional value of Wonder Bread. The administrative law judge found that complaint counsel had failed to sustain their burden of establishing the alleged violations and dismissed the complaint. In so doing, he found that there was no evidence to support a finding that Bates actively participated in the creation of the challenged advertising or knew or had reason to know that the advertising communicated the alleged deceptive claims. 1974 TRADE REG. REP. ¶20,464 at p. 20,383, citing Initial Decision of Administrative Law Judge, 72-75.

On appeal, the Commission disagreed, concluding that the advertisements falsely represented Wonder Bread as an extraordinary food for producing dramatic growth in children. It also concluded that Bates actively participated in the advertisements which it found to be false and misleading and that Bates knew or should have known that they were false. The order, however, fails to take into account these bases for Bates' liability and, in its broadest provision, directs the agency to cease and desist from:

> "[d]isseminating . . . any advertisement . . . which misrepresents, in any manner, the nutritional content, efficacy or functional value to the user for the normal use of any [food] product by consumers." 1974 TRADE REG. REP. ¶20,464 at p. 20,390.

No provision is made for innocent violations. No provision is made for reasonable reliance by the agency on information provided to it by its client. Even the agency's own independent verification of claims would not be a sufficient defense. The agency is made absolutely liable without regard to the degree of care it exercises.

The purpose of this brief *amicus curiae* is to demonstrate that the Commission's order, as entered against Bates, has no basis in the holding of this case and is contrary to the well established standard of agency responsibility.

Summary of Argument

The position of the A.A.A.A. is that the order entered against Bates should be modified to reflect the basis upon which its liability was predicated—its knowledge or what its knowledge should have been as to the falsity of the claims in the advertising.*

Argument

The Order Entered Against Bates Should Include A "Knew or Had Reason to Know" Clause.

A. The Test of Agency Responsibility

One of the first cases in which an agency was held liable for deceptive advertising is the "Rapid Shave" case against Colgate-Palmolive Co., Inc. and its agency. In that case, the Commission charged that the use of a sandpaper test to demonstrate the moisturizing ability of Rapid Shave was false and misleading because a mock-up was used in the television demonstrations instead of real sandpaper. A cease and desist order was entered against both Colgate-Palmolive and the agency under which the same restrictions were placed on both. *Colgate-Palmolive Co., Inc.*, Docket No. 7736, 59 F.T.C. 1452 (December 29, 1961).

On appeal, the First Circuit held that it was proper to enter an order against the agency but it made the following observation relative to agency responsibility:

> "[W]ith respect to the respondent Bates, we think there may well be a distinction between a principal and an agent in the permissible scope of an order. In some degree a principal may well be held to adver-

* Assuming that this Court affirms the entry of an order against Bates. Nothing in this brief is intended to imply that any order against Bates is justified on the record or that the order is proper in respects other than the one addressed herein.

> tise at his peril. But we have reservations as to how far it is appropriate to go in the case of an agent, in the absence, at least, of any suspicion on its part that the advertisement is false." 310 F.2d 89, 95 (1962).

Despite its determination that the qualities of Rapid Shave had been misrepresented, the Court set aside the order on the mock-up issue and directed that a new order be entered. The new order which was proposed by the Commission contained separate provisions for Colgate-Palmolive and the agency under which both were directed to cease and desist from (1) using a mock-up in an advertisement in which the demonstration was represented as actual proof and (2) advertising any shaving cream by claiming for it qualities it did not possess. These provisions were identical except that, in the case of Bates, the second provision contained a "knew or had reason to know" defense. In the opinion which accompanied this proposed order, the Commission explained that the defense had not been included in the mock-up portion of the order because "the agency will necessarily know of the use of mock-ups in commercials which it itself prepares." *Colgate-Palmolive Co. and Ted Bates & Co., Inc.*, Docket No. 7736, 62 F.T.C. 1269, 1278 (May 7, 1963). Nevertheless, that defense was subsequently added to the mock-up portion of the order.

Again the First Circuit set aside the order, 326 F.2d 517 (1963), a ruling which was reversed by the Supreme Court. 380 U.S. 374 (1965). Although the issue of agency responsibility was not before the Supreme Court, it noted that the "knew or had reason to know" clause

> "was added to the order for the benefit of respondent Bates in recognition of the different positions of clients and advertising agencies which often do not have all the information about a product that the client has." 380 U.S. at 382, n. 8.

The "knew or should have known" standard for agency liability was reaffirmed in the "Sucrets" case, *Doherty,*

Clifford, Steers & Shenfield, Inc. v. *FTC*, 392 F.2d 921 (6th Cir. 1968). In the initial decision, the hearing examiner found a manufacturer liable for the false advertising of its throat lozenges. He also found that the agency had actively participated in the preparation of the advertisement and, on that basis, entered an order which ran against both the agency and the manufacturer. *Merck & Co., Inc.*, Docket No. 8635, 69 F.T.C. 526 (April 8, 1966).

On review, the Commission agreed with the hearing examiner that the agency should be held, "but not solely because it was a mere 'participant in the preparation of the advertising'." It found, in addition, as an essential ingredient of liability, that the agency should have known of its deceptive capacity. 69 F.T.C. at 558. It also held that the facts warranted a broadening of the order to include any proprietary throat preparations but, as to this portion of the order, it expressly provided for a "knew or had reason to know clause." 69 F.T.C. at 560, 563.

On appeal the Commission's order was affirmed in its entirety. In the appeal, the agency challenged, presumably as overly broad, that portion of the order entered against it under which it was required to cease and desist from

> "Disseminating . . . any advertisement which misrepresents . . . the efficacy or therapeutic value of any throat lozenge or similar preparation: provided, however, that it shall be a defense hereunder that respondent neither knew or had reason to know of the falsity or deceptive capacity of such advertisement." 392 F.2d at 927.

With respect to this portion of the order, the Court found that the agency was "protected adequately" by the "knew or had reason to know" proviso. 392 F.2d at 929.

The standard of agency responsibility has not changed since the "Rapid Shave" and "Sucrets" cases and what an

agency either knew or should have known remains a prerequisite for liability.

B. Past Commission Practice

In apparent recognition of the appropriateness of the result reached in contested cases, the Commission has accepted the standard of liability which is embodied in the "Rapid Shave" and "Sucrets" cases in many of its consent orders to cease and desist. Representative orders have directed agencies to cease and desist from:

> "Represent[ing] . . . that a claim . . . concerning the comparative performance . . . of [analgesic products] has been established where there exists a substantial question, recognized by [qualified] experts . . . as to the validity of such claim, unless the respondent can establish that it neither knew or had reason to know of the existence of such substantial question. . . ." *Benton & Bowles, Inc.*, Docket No. C-2403, 82 F.T.C. 1444, 1449 (May 22, 1973).
>
> * * *
>
> "Advertising any [of the covered products] by presenting . . . a demonstration . . . that . . . purports to be proof of any fact or product feature . . . when, in fact, such demonstration . . . does not constitute actual proof thereof and respondent knew or should have known that such was the case." *American Home Products Corp.*, Docket No. C-2298, 81 F.T.C. 579, 586 (October 6, 1972).
>
> * * *
>
> "Representing . . . that [the covered products] will remove all types of stains when respondents knew or should have known that such representation was false or deceptive." *Lever Brothers Co., Inc.*, Docket No. C-1899, 78 F.T.C. 619, 624 (April 12, 1971).

The same defense was provided for in *Toshiba America, Inc.*, Docket No. C-2239, 81 F.T.C. 5 (July 3, 1972). There,

the advertising agency was directed to cease and desist from representing, in connection with the advertising of microwave products, that standards had been issued by HEW, that the covered products conformed to such standards, and that those products had been tested and approved by any private or governmental program. Each specific prohibition was followed by the clause "when respondent . . . knew or should have known that such representation was false or deceptive." 81 F.T.C. at 10-11.

The Commission has been willing to incorporate this clause even in extremely narrow orders. In *Sharp Electronics Corporation*, Docket No. C-1849, 78 F.T.C. 53 (January 13, 1971) for example, the advertising agency was ordered to cease and desist from

> "Using any figure or size designation to refer to the size of the picture shown by a television receiving set . . . unless such indicated size is the actual size of the viewable picture area. . . . If the indicated size is other than the horizontal dimension of the actual viewable picture area such size designation shall be accompanied by a statement . . . showing the manner of measurement: *Provided, however*, That it shall be a defense hereunder that respondents neither knew nor had reason to know that the size indicated was other than the horizontal dimension of the actual viewable picture area." 78 F.T.C. at 59-60.

Thus, in cease and desist orders which range from the extremely broad to those directed at very specific practices, the Commission has recognized the practical limits of the knowledge of an advertising agency and has made those limits a defense by the inclusion of a "knew or had reason to know" clause.

C. The Standard Applied to Bates

In the case under review, the Commission tested Bates' conduct against the established standard for agency liability as applied in *Doherty*:

> "An agency is clearly liable for the advertising it has created . . . unless it can be shown that it did not know or could not know that the challenged advertising was false." 1974 TRADE REG. REP. ¶ 20,464 at p. 20,384.

The Commission found that the type of activities which Bates engaged in were "virtually identical" to those engaged in by the agency in *Doherty* and, as in *Doherty*, it concluded:

> "Bates clearly participated in the development of the challenged advertisements and it clearly knew or should have known, that these representations were false." 1974 TRADE REG. REP. ¶ 20,464 at p. 20,385.

The orders in both cases contain similar provisions: the agency in *Doherty* was ordered to cease and desist from misrepresenting the efficacy of throat lozenges; similar restrictions were placed upon Bates with respect to the broader category of food products. But the two orders differ in an essential respect: the one in this case does not include a "knew or had reason to know" clause.

D. The Implications of the Failure to Include a "Knew or Had Reason to Know" Clause

The consequences for Bates of an order which would make it liable without fault for any misrepresentations of nutritional content, efficacy or functional value over the extremely broad and important range of all food products are obviously serious. The implications of such an order for the Association's members, if it is sustained by this Court, concern the Association. What would it portend for Commission policy in the future?

Cease and desist orders. The Commission would be encouraged, at the very least, to insist on strict liability orders against all advertising agencies, whether the orders are contested or negotiated. This would have an unduly adverse effect on agencies subjected to such orders and on their ability to create helpful, informative advertising.

An agency operating under a strict liability order could, without deceptive intent and after the exercise of all due care, discover that it had violated the order and become liable for civil penalties which could amount to $10,000 per day.* Its lack of willfulness or intention might be considered by the Court as a mitigating factor in determining the extent of the penalties to be imposed but would not provide a defense to an action by the government to recover these penalties. See, for example, *United States* v. *H. M. Prince Textiles, Inc.*, 262 F. Supp. 383 (S.D.N.Y. 1966).

An agency operating under a strict liability order would have the intolerable choice of either (1) relying upon product information furnished by its client and risking a violation of the order if the information proved inaccurate, however reasonable its reliance; (2) attempting to independently verify all information supplied by its client.

If an agency chose the first alternative, the risk of substantial penalties might well lead it to avoid significant factual claims, especially for new or improved products, and reduce the flow of product information to the consumer.

The second alternative would be economically feasible, if at all, for only the largest and most successful agencies. Small and medium sized agencies could not compete on

---

* Under Section 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. §45(*l*) the penalty for violating a final Commission order can be up to $10,000 for each violation. Each separate violation of an order is a separate offense except that each day of the continuing failure to obey an order is deemed to be a separate offense.

this basis. Furthermore, even independent verification of product claims, supposing it were possible, would not afford a defense if the attempted verification was in error.

It is apparent that the restraints imposed on an agency by a strict liability order would not enhance the usefulness of its advertising to the consumer and would put it at a substantial competitive disadvantage in retaining or competing for clients wherever the order, as here, covers a wide product category.

Standard of Agency Liability. Affirmance of the order without modification might also lead the Commission to attempt to apply more stringent standards of agency liability than those sanctioned by existing law. This possibility is suggested by the following confusing statement in the Commission's opinion:

> "Unless advertising agencies were under a duty to make independent checks of information relied upon to frame their advertising claims, the law would be placing a premium on ignorance. *In Re Dolcin.* [1957 TRADE CASES ¶ 68,766.] 247 F.2d 524, 534 (D.C. Cir. 1956), *cert. denied,* 353 U.S. 988 (1957)." 1974 TRADE REG. REP. ¶ 20,464 at p. 20,385.

This statement is doubly confusing. First, *In Re Dolcin* had nothing to do with the obligations of advertising agencies with respect to product claims but rather involved the duty of corporate officers to effect compliance with a court order. Second, the issue of verifying client information is not presented in any way by the record in this case. Nevertheless, the Commission refused to retract this dictum though requested by Bates to do so in its petition for reconsideration. Petition For Reconsideration of Ted Bates & Company, Inc., p. 12.

The responsibility for substantiating product claims plainly rests with the advertiser, not its advertising agency. The advertiser controls the characteristics and quality of its own products and alone possesses the financial resources

and technical know-how to conduct and evaluate appropriate performance tests or to commission and evaluate such testing by independent organizations. The advertising agency business is a small business of professionals in communication. Total industry employees nationwide are estimated at only 60,000, of which 36,500 are employed by member agencies of the A.A.A.A. The *gross income* of *all* A.A.A.A. agencies in 1973 was less than half the $2.4 billion *net profit* of a single large advertiser, General Motors, as reported in Moody's Industrial Manual (1974). The average net profit of A.A.A.A. member agencies has not exceeded 1% of billings in any of the past 10 years—about $8,200 for each $1 million of billing in 1973. (Ten Year Record of A.A.A.A. Advertising Agencies' Costs and Profits, as released August 5, 1974). Quite apart from the question of what public interest would be served by needless duplication of product testing, it is clear beyond question that the advertising agency business does not have the financial or manpower resources to accomplish independent verification of product claims.

This does not mean that agencies should behave irresponsibly or that they should not take reasonable steps to satisfy themselves that adequate substantiation exists for all claims made in advertisements which they create and place. The Association requires from all of its members a pledge that they will not knowingly produce advertising which contains "false or misleading statements or exaggerations" or claims which are "insufficiently supported, or which distort the true meaning [or] practicable application of statements made by professional or scientific authority." (A.A.A.A. Standards of Practice) What is reasonable for an agency to do will depend on the facts of a particular case. But requiring due care is a far cry from imposing strict accountability or insisting on such wasteful and counter-productive duplication of effort as the independent verification of claims which an agency reasonably believes have been adequately tested and substantiated by its client.

For these reasons, if the Court holds that an order may properly be entered against Bates, the order should be drawn so as to eliminate the confusion raised by the Commission's dictum. Such an order should reflect the basis on which a violation is found instead of one suggested by the Commission under a novel theory which has nothing to do with the case at hand.

Conclusion

The Commission found that Bates made representations which it knew or should have known were false. If this finding should be affirmed by this Court, the order against Bates should be modified to reflect this basis for the violation found and the established test of agency responsibility by the addition of a "knew or had reason to know" clause.

Respectfully submitted,

DONOVAN LEISURE NEWTON & IRVINE
30 Rockefeller Plaza
New York, N. Y. 10020
Attorneys for the American Association of Advertising Agencies, Inc. as Amicus Curiae

Of Counsel:

MAHLON F. PERKINS, JR.
THOMAS R. TROWBRIDGE, III